SUPREME COURT, U. S.

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No. 74-1283

In the Supreme Court of the United States

OCTOBER TERM 1974

C.N.S. ENTERPRISES, INC., THOMAS G. COULES and CLAYTON NASSOS,

Petitioners,

vs.

G. & G. ENTERPRISES, INC., GISELLE STRAUSBURGER, GLADYS LUCAS, KIMLIS SALES COMPANY, ROBERT W. CASEY, and NATIONAL BANK OF AUSTIN,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Petitioners C.N.S. Enterprises, Inc., Thomas G. Coules and Clayton Nassos, plaintiffs-appellants in the court below, pray that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit entered in this case.

Opinion Below

The opinion of the Seventh Circuit, reported at 508 F.2d 1354 (7th Cir. 1975), is set forth in Appendix 1. The District Court had issued no written opinion; the transcript of its oral ruling is attached as Appendix 2.

Jurisdiction

The opinion and judgment of the Court of Appeals for the Seventh Circuit were entered on January 13, 1975 and became final on that date. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

Questions Presented

1. Does the Securities Exchange Act of 1934, and Rule 10b-5 adopted thereunder, afford protection to the purchaser of the assets and good will of a business who pays for them partly with cash and partly with long-term personal and corporate notes?

2. Is the giving of a personal and corporate long-term promissory note in exchange for the assets of a business a purchase or sale of a security within the meaning of Section 10(b) of the Securities Exchange Act of 1934?

3. Do "commercial" notes fall outside the "any note" definition of a security in the Securities Exchange Act of 1934?

Statutes and Regulations Involved

The statutes and regulations involved herein are the Securities Exchange Act of 1934 (15 U.S.C. § 78(a) et seq.) and Rule 10b-5 of the General Rules and Regulations promulgated thereunder by the Securities Exchange Commission (17 C.F.R. § 240-10b-5). The text of the pertinent provisions are reproduced as Appendix 4.

STATEMENT OF THE CASE

Petitioners C.N.S. Enterprises, Inc., ("C.N.S.") Thomas G. Coules ("Coules") and Clayton Nassos ("Nassos") brought this action for rescission or damages charging that certain of the respondents violated Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78j(b)) and Rule 10b-5 promulgated pursuant thereto. Jurisdiction in the District Court was predicated upon Section 27 of the Exchange Act (15 U.S.C. § 78aa).

Respondents G & G Enterprises, Inc. ("G & G"), Giselle Strausburger ("Strausburger") and Gladys Lucas ("Lucas") were the owners and operators of a coin-operated laundry and dry cleaning business in Justice, Illinois known as the Village Well. Respondents Kimlis Sales Company ("Kimlis") and Robert Casey ("Casey") had licensed the operation of the Village Well. The fixtures and equipment of the business had been pledged to secure a loan from respondent National Bank of Austin ("Austin") to G&G, Strausburger and Lucas.

In the latter part of 1971, G & G, Strausburger, Lucas, Kimlis and Casey set about finding a new owner and operator for the business and approached petitioners with a proposal that they purchase it. Negotiations continued over the next few months and were concluded on January 20, 1972 with the purchase by C.N.S. of the fixtures, merchandise, business and good will of the Village Well.

In exchange for the business, petitioners took over the sellers' existing indebtedness by issuing their own individual and corporate promissory note in the amount of $73,515.26 to Austin and assuming the existing chattel mortgage in that amount covering the fixtures and equipment. The balance of the purchase price was paid in cash

to G & G, Strausburger and Lucas, with $20,000 of that balance being the proceeds of an additional loan by Austin to petitioners secured by a junior chattel mortgage on the equipment and for which petitioners issued a second promissory note to the bank.

On September 29, 1972 petitioners filed this action. The gist of the Complaint (printed in its entirety as Appendix 3) is that during the negotiations leading to the sale, certain of the respondents made false representations and concealed material facts regarding the amount of monthly sales at the Village Well.

Each of the respondents filed a motion to dismiss attacking the District Court's subject matter jurisdiction. On May 2, 1973 the trial court denied the motions to dismiss and ordered that answers be filed; however, on September 26, 1973 the court reconsidered its prior decision, vacated the May 2d ruling and dismissed the complaint for lack of federal jurisdiction.

C.N.S., Coules and Nassos appealed from the order of dismissal. The Seventh Circuit panel hearing the case affirmed holding that the promissory notes issued in exchange for the assets were not securities within the meaning of the 1934 Act because they were "commercial notes" rather than "investment notes."

REASONS FOR GRANTING THE WRIT

This is an important case of first impression. The Seventh Circuit has severely restricted the breadth of commercial conduct which would otherwise be covered by the plain meaning of the federal securities laws. Its decision on the question conflicts with that of other courts of appeals.

A.

This Court Has Recognized The Importance Of The Question Presented But To Date Has Not Passed Upon It

Just last term this Court acknowledged the importance of the question we seek to present but was not then asked to resolve it. In *Alberto-Culver Company* v. *Scherk,* 484 F.2d 611, 615 (7th Cir. 1973), reversed on other grounds 417 U.S. 506 (1974), the Court of Appeals for the Seventh Circuit had held *inter alia* that the exchange of the assets of certain European business entities "for cash and promissory notes involves a 'security' within the meaning of the Securities Exchange Act of 1934." Certiorari was granted on another issue in the case; however, on the question of whether a security transaction was involved this Court stated (417 U.S. at 514-5, n. 8):

> "We do not reach, or imply any opinion as to, the question whether the acquisition of Scherk's businesses was a security transaction within the meaning of § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. Although *this important question* was considered by the District Court and the Court of Appeals, and although the dissenting opinion . . . seems to consider it controlling, the petitioner did not assign the adverse ruling on the question as error and it was not briefed or argued in this Court." (Emphasis added)

The four dissenting justices in *Scherk* also deemed the question of whether a "security" was involved to be important; they concluded that the promissory notes issued in return for assets were "securities" within the meaning of the 1934 Act. (417 U.S. at 522-3)

Given this Court's express recognition of the importance of the question of whether promissory notes issued in return for the assets of a business are "securities" within the meaning of the anti-fraud provisions of the federal securities laws, we urge that it be settled in the present case.

B.

The Decision Below Conflicts With The Plain Meaning Of The Statute Involved And With The Policy Adopted By This Court In Interpreting The Federal Securities Laws

Section 3(a)(10) of the 1934 Act (15 U.S.C. § 78c(a)(1)) defines security as including "*any* note" provided it has a maturity exceeding nine months. The anti-fraud provisions of the Act come into play in the case of "the purchase or sale of *any* security." (15 U.S.C. § 78j) The language employed by Congress in these sections is plain, "unequivocal and all-embrasive." *Movielab, Inc.* v. *Berkey Photo, Inc.*, 31 F. Supp. 806, 808-9 (S.D.N.Y. 1970), affirmed 452 F.2d 662, 663 (2d Cir. 1971).

This Court has consistently ruled that the Securities Exchange Act, as remedial legislation, ought to be construed broadly and that the determination of what is a security should not be circumscribed by narrow or restrictive concepts. *Tcherepnin* v. *Knight*, 389 U.S. 332, 336-9 (1967). At the very least, it is clear that (389 U.S. at 339):

> " 'Instruments may be included within any of [the Act's] definitions, as a matter of law, if on their face they answer to the name or definition.' "

What the Court of Appeals has done in the instant case, however, restricts the Congressional definition of security and carves out of the protection of the 1934 Act instruments ostensibly covered by it. Substituted for the recognizable Congressional concept of "any note," is the Seventh Circuit's notion of "a case-by-case factual determination" (App. 18) to be made on the basis of a rather amorphous set of "possible criteria." (App. 16-17)

C.

There Is A Conflict In The Circuits

The question of whether the issuance of promissory notes in exchange for the assets of a business is a "security" transaction for purposes of the anti-fraud provisions of the federal securities laws has been answered in conflicting ways by the courts which have been called to rule on it.*

The Second Circuit says "yes." *Movielab, Inc.* v. *Berkey Photo, Inc.*, 452 F.2d 662, 663 (2d Cir. 1971) (see also the District Court opinion 321 F.Supp. 806 (S.D.N.Y. 1970), as does the District Court in *MacAndrews & Forbes Co. v. American Barmag Corp.*, 339 F. Supp. 1401, 1405-7 (D.S.C. 1972), and as did the Seventh Circuit panel which decided the *Scherk* case.

The Third Circuit apparently says "no." *Lino* v. *City Investing Co.*, 487 F.2d 689, 694-5 (3d Cir. 1973).

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*There is even a conflict between panels within the Seventh Circuit itself. Compare the opinion in the instant case with that of the Court in *Alberto-Culver Company* v. *Scherk*, 484 F.2d 611, 615 (7th Cir. 1973), reversed on other grounds, 417 U.S. 506 (1974).

The Fifth Circuit, although not deciding a directly analogous case, would apparently agree with the Court of Appeals in the present case and carve commercial paper out of the coverage of the 1934 Act. See: *Bellah* v. *First National Bank*, 495 F.2d 1109 (5th Cir. 1974); *McClure* v. *First National Bank*, 497 F.2d 490 (5th Cir. 1974) *cert. denied* ..... U.S. .....; and *SEC* v. *Continental Commodities Corp.*, 497 F.2d 516 (5th Cir. 1974).

We submit that these conflicting views on so important a federal statute compel prompt resolution by this Court.

D.

The Seventh Circuit's Decision, If Left Standing, Will Have Wide-Ranging Detrimental Effects On The Uniform Application Of Federal Securities Laws

There is virtue in applying the broadly interpreted concept of "security" urged by the petitioners rather than the more restrictive case-by-case test of whether a note is "commercial" or is "investment" which has now been adopted by the Seventh Circuit. A person who deals with promissory notes, whether as giver or acquirer, will know that he must meet the standards of candor and forthrightness prescribed by the federal securities laws. And the courts that are to apply those laws will have a certain standard against which to apply them.

On the other hand, the unstructured test espoused by the Court of Appeals in the present case can lead to nothing but confusion for the courts which are obliged to apply it and could well serve as a haven for the malevolent who will seek to surround their instruments with the trappings of "commercialness." We submit that only mischief and uncertainty will result should the Seventh Circuit opinion be left standing.

CONCLUSION

For the foregoing reasons, petitioners respectfully pray that this Court grant a writ of certiorari to review the judgment of the Seventh Circuit in this case.

Respectfully submitted,

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PROOF OF SERVICE

I, Russell J. Hoover, attorney for Petitioners herein hereby certify that on the 11th day of April, 1975, I served the foregoing Petition For Writ of Certiorari on Respondents by mailing 3 copies thereof in duly addressed envelopes with first class postage prepaid, addressed to their respective attorneys of record as follows:

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